

## GERMAN CAPITALISM: DOES IT EXIST? CAN IT SURVIVE?

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In the roughly four decades between the end of the Second World War and German unification, West German society gave rise to a distinctive kind of capitalist economy, governed by nationally specific social institutions that made for strong international competitiveness at high wages and, at the same time, low inequality of incomes and living standards. However, by the late 1980s, when

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the differences in performance and social organisation between the West German economy and its main competitors came to be widely noticed, the continued economic viability of the 'German model' had begun to appear doubtful to many. Shortly thereafter, the survival of the German version of advanced capitalism became tied to its successful extension to the former East Germany. With the 1992 completion of the European Single Market, it became in addition dependent on the compatibility of German economic institutions with the emerging regime of the integrated European economy.

At the time of unification, West Germany was the most internationally successful of the major economies (Table 1). More exposed to the world market than both Japan and the USA, the country accounted for a significantly larger share in world visible exports than Japan, with roughly half its population, and for about the same share as the USA which has a population twice the Japanese. West German trade and current account balances, expressed as a percentage of gross domestic product (GDP), exceeded those of Japan and presented a stark contrast to the chronically deficit-ridden Anglo-American economies. This was in spite of the fact that German wages had long been considerably higher than Japanese and US wages.

Characteristically, the international success of the West German high-wage economy was accompanied by comparatively little internal inequality. The difference between high and average wages, as measured by the ratio of the ninth over the fifth decile of the wage spread, was much lower in Germany than in its major competitor countries. Similarly, German low wages, as represented by the first decile of the distribution, were significantly higher in relation to the

median (Table 2). Moreover, during the 1980s, at a time when in all other industrialised countries the wage spread increased, the relation of the high German wage to the median remained essentially unchanged, whereas the low wage increased substantially, from 61 to 65 per cent of the median wage. Furthermore, intersectoral wage dispersion was dramatically low in West Germany compared to both Japan and the USA, and so were the earnings differentials between workers in small and large firms (Table 3). In the latter respect, it is important to note that the employment share of small and medium-sized firms in West Germany was far higher than in Britain and the USA, and close to Japan in spite of a comparatively low wage differential. Finally, the ratio of German chief executive salaries over skilled wages, while higher than in Japan, was lower than in Britain and, in particular, the USA.

#### The economic institutions of postwar German capitalism

The West German combination of external competitiveness and normalised high-wage employment reflects the operation of a distinctive set of socioeconomic institutions. These, in turn, reflect a complex historical compromise between liberal capitalism, as introduced after the Second World War, and two different countervailing forces, social democracy and christian democracy--as well as between traditionalism and two alternative versions of modernism, liberalism and socialism, and of course between capital and labour. This compromise was struck, and became firmly institutionalised, at a time when both the communist wing of the labour movement and the authoritarian faction of the German business class were, for different reasons, excluded from political participation.

Under these circumstances, those who wanted to turn the new Germany into a liberal market economy had to accept the revival of a variety of traditionalist status protections--for farmers, civil servants, Mittelstand and the like--as well as an extensive welfare state and established labour unions. At the same time, the old middle classes, represented especially by the Christian Democratic Party, while successfully defending some of their protective institutions--like the special status of artisanal firms--had to learn to use these under the competition regime of a market economy and in the presence of a safely entrenched union movement. Labour, finally, was never strong enough, as it was in Sweden, to rid society of, for example, small firms, apprenticeship or works councils in the name of progress. Indeed, German unions were rebuilt after the war as Einheitsgewerkschaften, uniting previously divided socialist and Catholic movements, which contributed to the recognition by labour of the need to seek productive coexistence with non-socialist, traditional forms of social organisation, as well as class compromise in the workplace and beyond.

While the result of all this was certainly a capitalist market economy, it was one

that was and remains richly organised and densely regulated by a vast variety of institutions that have sprung from sometimes incompatible sources: from Mittelstand traditionalism to various ideological stripes of organised labour. While this makes Germany different from the USA, it also distinguishes it from Sweden, in that Germany never became a social-democratic society. Although workers and unions were able gradually to build a strong position for themselves in German capitalism, stronger than in all other large capitalist countries, the German political economy continued to allow for decentralised compromise and local commitments supplementing, underpinning and sometimes superseding the high politics of class accommodation at national level. On the other hand, although its political economy is highly institutionally coordinated, and regardless of many other, often striking parallels, Germany also differs from Japan, in that the institutions that embed its economy and shape its performance are politically negotiated and typically legally constitutionalised, rather than commanding compliance as a matter of informal obligation or as a result of successful conservative social engineering in a closed national or 'enterprise' community.

Compared to the other major capitalist economies, the institutional framework of the German economy can be summarily described as follows.[1]

1. Markets are politically instituted and socially regulated, and regarded as creations of public policy deployed to serve public purposes. The postwar competition regime is strict, resulting in comparatively low industrial concentration in most sectors. At the same time, wide areas of social life, like health care, education and social insurance, are not governed by market principles, and some markets, like those for labour and capital, are less so than others.

Competitive markets coexist with an extensive social welfare state, and political intervention and social regulation often interfere with the distributive outcome of markets, for example by building a floor under them. Also, small firms are in various ways shielded from the competition of large industry, or are publicly assisted in competing with it. Reflecting a history of fragmented markets offering little space for mass production, price competition is often mitigated by product specialisation.

2. Firms are social institutions, not just networks of private contracts or the property of their shareholders. Their internal order is a matter of public interest and is subject to extensive social regulation by law and industrial agreement. Also, managers of large German firms face capital and labour markets that are highly organised, enabling both capital and labour to participate directly in the everyday operation of the firm and requiring decisions to be continuously negotiated. Decisions thus take longer, but are also easier to implement once

taken.

German capital markets are not 'markets for control'. Many companies continue to be privately held; only a small part of the productive capital is traded at the stock exchange; banks may hold equity; shareholding is highly concentrated; and shares and companies do not often change hands. Firms finance themselves less through equity than through long-term bank credit. Since banks can cast proxy votes on behalf of shares they hold in deposit, they can effectively monitor management performance, which allows them to give firms long-term loans and creates an incentive for them not to speculate with stock. Labour is similarly present within firms, with workforces exercising legal rights to co-determination through works councils and, where applicable, supervisory board representation. Together with collective bargaining and legal regulation, co-determination supports an employment regime that makes it difficult for employers to dismiss workers, resulting in employment spells almost as long as in Japan, and much longer than in the USA (Table 4). Turning labour into a more fixed production factor and making it more similar to capital than in market-driven employment, this encourages high employer investment in skills.

3. The postwar German state is neither laissez-faire nor etatiste, and is best described as an enabling state. Its capacity for direct intervention in the economy is curtailed by vertically and horizontally fragmented sovereignty, and by robust constitutional limitations on discretionary government action. Vertical fragmentation between the federal government and the Lander closely limits what political majorities at national level can do, making political change slow and policies less than immediately responsive to electoral majorities. The electoral system, which favours coalition governments, further adds to the centrist drift and the long response time of German politics.

Horizontally, sovereignty is divided between the federal government and a number of independent authorities insulated from electoral pressure, like the Bundesbank or the Federal Cartel Office. Policy objectives like monetary stability and competitive markets are in this way removed from government discretion and depoliticised. A similar effect is caused by strong constitutional protections, like the right of unions and employers' associations to regulate wages and working conditions without government interference. The result is both immobility and predictability of government policies, precluding rapid political innovation and allowing economic agents to develop stable expectations, pursue long-term objectives and build lasting relations with one another.

Constitutionally dedicated to competitive markets and a hard currency, the postwar German state lacks capacity for a selective industrial policy. In

compensation, it offers firms and industries a wide range of general infrastructural supports, like high public spending on research and development. Moreover, to safeguard social cohesion, the federal government spends a considerable share of the GDP on social protection. It also accepts a constitutional obligation to provide for 'equal living conditions' in all Lander, which has given rise to an extensive redistributive system of revenue sharing. To expand its capacities in line with its responsibilities, the German state has developed an extraordinary ability to assist groups in civil society in organising themselves, devolving on them governance functions that would otherwise have to be either performed by the state or left to the market. It is through state-enabled collective action and quasi-public, 'corporatist' group self-government that the German political economy generates most of the regulations and collective goods that circumscribe, correct and underpin the instituted markets of soziale Marktwirtschaft.

4. Widespread organised cooperation among competitors and bargaining between organised groups, conducted through publicly enabled associations, is probably the most distinctive feature of the German political economy. Governance is delegated either to individual associations or to collective negotiations between them, with the state often awarding its outcome legally binding status. Associations performing quasi-public functions are typically granted some form of obligatory and quasi-obligatory membership, helping them overcome the free-rider problems associated with collective goods production and giving Germany the most densely organised civil society among the larger countries.

Publicly enabled associations regulate instituted markets in a variety of ways. German business associations, prevented by law from operating as cartels, turn price into quality competition, by promoting product specialisation and setting and enforcing high quality standards. To the same effect, employers' associations prevent low-wage competition by negotiating uniformly high labour standards with national industrial unions. To make the outcome economically viable, 'dual' training, with associatively organised cooperation between competing firms, between government and industry, and between business and labour, procures the skill base firms need to be competitive in quality markets. For the same purpose, associations also organise cooperative research and technology transfer. Legally enabled associational support is especially vital for small and medium-sized firms.

Above all, associative regulation constitutes the single most important source of egalitarianism in the German economy. Joint governance of labour markets by employers associations and centralised industrial unions is so firmly established that by the 1980s Germany had become the only major economy in which the 'postwar settlement' between capital and labour remained intact

(Table 5). Although unionism has been comparatively stable, associative labour market governance in Germany is accomplished above all through near-universal collective bargaining coverage, thanks to strongly institutionalised industry-wide negotiations and legal extension of agreements. More than anything else, it is the German system of centralised and interconnected collective bargaining that is responsible for the low dispersion of wages in Germany between individuals, industrial sectors, and small and large firms.

5. German economic culture is often traditionalist. Savings rates are high, and consumer credit, although increasing, remains low by comparison. Price competition is mitigated by socially established preferences for quality. Markets do not per se confer merit: social status and solidarity interfere, and security is regarded as important. Speculation is not valued. Continuous monitoring of one's shortterm balance of economic advantage is not a social norm, encouraging long-term orientations and commitments and supporting, among other things, a redistributive tax system. Professional competence is highly regarded for its own sake; German managers tend to be engineers and authority at the workplace is based on superior technical knowledge. Collectivism and discipline have given way as core cultural values to privacy and autonomy from organisational control and market pressure, as shown by strong cultural support for short working hours, low participation in paid employment, and a qualification-based organisation of work. Work-related knowledge is vested in an occupational qualification structure, where the distinction between knowledge and skills is conceived as gradual rather than categorical. Institutionally, this is reflected in the unique vocational training system, with its long socialisation periods leading to portable certificates under national regulations negotiated between unions and employers associations.[2]

#### Institutional structure and economic performance

In the 1970s and 1980s the institutional structure of the West German economy conditioned and sustained a distinctive pattern of performance that happened to be highly competitive in world markets. High costs originating in socially circumscribed labour markets ruled out price-competitive production throughout the economy and forced firms to seek survival in quality-competitive international markets. Here, the same set of German institutions that constituted a prohibitive liability in price-competitive markets served as a competitive asset-with what would be debilitating rigidities for firms trying to compete on price offering enabling flexibilities to firms pursuing quality-competitiveness through upgrading and customisation of products.[3]

While imposing constraints that make low-cost production prohibitively costly, German economic institutions offer firms rich opportunities for strategic upgrading. An extended social welfare state, negotiated management under co-

determination, and encompassing collective bargaining place the economy under social pressures that prevent anything beyond moderate differentiation of wages and working conditions. Unions and business associations, then, find it in their common interest to deploy their quasi-public powers to help the economy move into quality-competitive markets, through cooperative upgrading of skills, work organisation, technology and products. Just as the universality of the pressure accounts for the fact that only very few German products have remained price-competitive, the general availability of cooperative supports, also generated by encompassing labour-inclusive associative governance under state facilitation, explains the high general competitiveness and low sectoral specialisation of the German manufacturing sector. How successful this system has been is indicated by the fact that, before unification, the manufacturing sector was proportionately larger than in any comparable country, despite having to pay much higher wages. It also was and still is internationally competitive across a uniquely wide range of products, making Germany by far the world's most diversified export economy.

German industrial upgrading is typically slow and gradual but also continuous, reflecting an institutional infrastructure that makes for long decision times while fostering long-term orientations. The resulting pattern of innovation is one that is more likely to generate improvements of existing products of existing firms and sectors than to give rise to new sectors. Generally, irreversible decisions, steady commitments and delayed responses in German institutions make for slow fluctuations, up or down, in economic activity and performance; for fiat cyclical movements, especially compared to the USA; and for low dispersion of outcomes, all of which are conducive to stable cooperation and steady improvement across the board. Averages are typically high, coefficients of variation low, and extreme cases are rare at both ends.

The broad movement of the German economy in the 1970s and 1980s into quality-competitive markets was helped by the traditional preference of German consumers for quality. Traditionalism contributed also to a high savings rate, which helped generate the patient capital needed for continuous upgrading of products and production factors. Within firms, capital that could not easily be liquidated and committed labour, able to exercise voice as an alternative to exit, enabled managements to take the long view, based on stable bargains with and between both. In politics, divided and immobile economic government enshrined a currency regime that foreclosed devaluation to restore price-competitiveness and offered investors insurance against electoral volatility.

Above all, the success of the 'German model', as long as it lasted, derived from the way in which it utilised social pressures for an egalitarian distribution of economic outcomes to generate an egalitarian distribution of productive

capabilities, with the latter in turn enabling the economy to underwrite the former. Complementing social constraints on some economic strategies with productive opportunities for others, and thereby creating a pattern of production capable of sustaining a socially desirable but economically improbable pattern of distribution, the system managed to combine competitive efficiency with high economic equality and social cohesion.

Three conditions of success: a socioeconomic tightrope walk

Competitive success of an institutionalised high-wage economy like Germany's is inevitably precarious and fragile, as it must simultaneously accommodate international markets and domestic pressures for equality and social cohesion. Three highly elusive conditions must be met for this to be possible.

1. World-wide product markets for quality-competitive goods must be large enough to sustain full employment in an economy that has barred itself from serving price-competitive markets. The volume of demand that a quality-competitive economy can attract depends on the historical evolution of global demand generally, the competitive capabilities of other economies, successful domestic product innovation expanding quality-competitive markets at the expense of price-competitive ones, and domestic production costs not exceeding the point where the price differential between quality-competitive and price-competitive goods becomes too large for too many customers.
2. Product innovation must proceed fast enough to give the economy a sustained edge in the quality-competitive markets in which it competes. This requires continuous high investment in research and development. Product leadership also depends on a country's culturally rooted pattern of knowledge production and diffusion, as well as on management, technology use, work organisation and skill formation continuing to match changing markets and technologies.
3. The economy's labour supply must fit the volume and character of demand in quality markets, providing the skills needed to serve such markets and allowing for a satisfactory level of employment in high-skill and high-wage jobs. This requires that no more than a few among a country's workforce be unable to function in high-skill jobs. Only if their numbers are small can they be taken out of the labour market and sustained by a welfare state funded from the rich proceeds of high quality-competitiveness. Employment for the others must be made possible by a labour market policy--public, private or both--that upgrades their skills to a level where they can earn the high wages mandated for them by collective bargaining and social citizenship. Moreover, to the extent that markets for high-quality products cannot be indefinitely expanded by accelerated product innovation, demand-side employment



constraints must be accommodated by cutting the labour supply, through reducing working time or retiring part of the workforce, to allow for an equitable distribution of the available high-wage employment among the vast majority.

Socially acceptable redistribution of employment is possible only as long as quality-competitive product markets are large enough for institutionally mandated underemployment to be small enough to be welcomed as leisure. If underemployment incurred in defence of normalised high-wage employment exceeds the very low level that is socially acceptable, thereby turning into unemployment--whether because international quality markets have become crowded; the rate of innovation in the domestic economy has slowed down in comparison to relevant competitors; labour market policy has failed, for whatever reason, to upgrade skills or retire capacity efficiently and equitably; or wage moderation, containment of social spending and process innovation have failed to compensate for limited product advantage or the failures of labour market policy--the costs of social support for those outside the labour market must soar. This of course further depresses the economy's international competitiveness, and high equality among the employed is bound to be increasingly overshadowed by deep inequality between the employed and a large number of long-term unemployed.

At this point, social institutions that rule out low-wage employment in order to generate high-wage employment become increasingly likely to be overridden by market forces. As the labour constraint that drives industrial strategy in an instituted high-wage economy is weakened, with low-wage employment becoming an option for profit-seeking employers and work-seeking workers, its virtuous supply-side effect wanes, eventually resulting in even less high-wage and high-skill employment than there might have been without deregulation. In the ensuing spiral of institutional erosion and structural downgrading, the difference in governance and performance between an instituted high-wage and a liberal market economy disappears.

### **Can it survive?**

In 1993 the German economy moved into its worst recession in postwar history, raising the possibility that the German economic Sonderweg might finally have ended. In the following I will distinguish three sources of the present malaise of German capitalism: (1) a possible secular exhaustion of its capacity to perform the complicated balancing acts required for its success; (2) the strains caused by the shock of unification; and (3) the changing conditions in the global economy of which Germany is part. My argument will be that, while in normal circumstances the 'German model' may or may not once again have found a way out of its difficulties, unification may have so much

exacerbated the country's difficulties as to make them insurmountable. Moreover, even if East Germany could against the odds be incorporated into a united Germany on West German terms, the simultaneous incorporation of Germany as a whole in a globalised world economy exposes German economic institutions to new kinds of pressures that they may be unable to withstand.

The model exhausted?

If there was one blemish on West German economic performance in the 1980s, this was persistent high unemployment. To be sure, unemployment in the much more market-driven economy of the UK was even higher throughout the period (Table 6). But in Germany, with its institutionalised commitment to social cohesion and its deployment of labour constraint as a supply-side stimulus, it posed more fundamental problems. This explains why German unions in the 1980s used their political and industrial clout to redistribute employment by reducing working time (Table 7)--foregoing economic growth by cutting labour input (Table 8) and trading potential increases in money income for leisure, all in an effort to defend high equality. They also tried to win the support of employers and government for a nation-wide 'training offensive', aimed at raising worker skills to a level where ideally everybody could be employed at high wages in a flat wage structure, so as to avoid the need to restore full employment by wage cuts, broader wage dispersion and a proliferation of low-wage and low-skill jobs.

This strategy was not entirely ineffective. By the end of the 1980s unemployment was beginning to decline, and overall employment and workforce participation had slightly increased. Still, a sizeable number of unemployed, almost half of them long-term, remained. Depending on the perspective, this could be blamed on the institutional rigidities of German labour markets, or alternatively on lack of effort in labour market policy and working time reduction. It could also be attributed to costs, of labour or the welfare state, having crossed the threshold beyond which they begin to count again even in quality markets. But it could as well have been the result of deficient product innovation failing to keep the economy quality-competitive in spite of and together with its institutional rigidities and high social costs. As high unemployment became increasingly entrenched, the question for those trying to save the system became whether there were possibilities for speeding up innovation and improving labour market, training and working time policies that, if inevitable and together with some negotiated cost-cutting, could restore high-wage full employment; this would pre-empt pressures for more markets, more managerial prerogative and a liberal Ordnungspolitik of deregulation. Conversely, arguments for such changes to the system came to be based on claims that improved product innovation alone would not win back a sufficiently large market share; that labour market, training and working time policies had

reached their financial, social or other limits; and that effective cost reduction was achievable only by deregulation returning allocational decisions to 'market forces'.

To many, the collapse of employment in the 1993 recession confirmed earlier diagnoses of endemic weaknesses. Japanese advances in traditionally German quality markets suggested that the era of undisputed German product leadership had ended, and with it the capacity of German industry to evade price competition. Also, growing pressures on German firms to cut costs confirmed suspicions that, in times of assured product advantage, German managements had neglected process innovation, especially the introduction of 'lean' production methods, not least in response to powerful works councils defending jobs under endemic high unemployment. Mounting mass dismissals and rapidly rising unemployment rates, not just in East but also in West Germany, seemed to show that the possibilities for working time reduction and early retirement had been exhausted. And the limitations of skill upgrading as a means of full employment policy seemed to be indicated, among other things, by a higher-than-ever number of young people dropping out of the apprenticeship system, apparently because of its significantly raised intellectual demands.

Perhaps most disturbing were concerns, also older than the crisis but dramatised by it, that the German system of knowledge production and diffusion might have structurally and, barring major institutional adjustments, irreversibly lost touch with changing markets. With the Japanese successes of the late 1980s, competitive advantage in quality markets appeared to derive increasingly from fast product turnover rather than slow product refinement. The German system of innovation, management and 'organisational culture'--with applied research conducted by research institutes and associations close to industrial users linking up with widely available shopfloor-generated worker skills vested in long-term commitments to quasi-professional occupational identities, and governed by consensus-building institutions like co-determination--seemed far better suited to the former than to the latter, and unlikely to be able to move from the one to the other at short notice.

Even before unification, German capitalism may thus have reached its limits with respect to the size of its possible product markets, its capacity to maintain product leadership, its ability to manage its labour market, or more than one of these at the same time. The indications were that, in response, it had slowly begun to deteriorate into a pattern where socially instituted markets, negotiated management, structurally conservative politics, quasi-public associational governance and cultural traditionalism no longer resulted in industrial upgrading, but in an ever-expanding number of people being relegated to an ever more expensive and, ultimately, unsustainable social

safety net in the widest sense, being kept out of employment at public expense or in employment at private expense.

Whether or not these tendencies could have been corrected in normal conditions is a moot question. Experience suggests that prospects for consensual cost-cutting were not entirely bleak. German collective bargaining, together with the institutionalised monetarism of the Bundesbank, has always been remarkably good at keeping unit labour costs under control, without deregulation and indeed in order to prevent it.[4] Unification, however, and the boom and bust that followed it did nothing to resolve whatever structural problems may have existed at the time. Instead, it imparted an historical shock to the 'German model' that may well have been powerful enough to throw it off course once and for all.

#### The shock of unification

The crisis of the early 1990s might have come even without unification, because of a secular exhaustion of the 'German model'. But it could also have been caused by unification alone, since rebuilding a country as large as East Germany would have been demanding even for the strongest economy. Sorting out the two explanations is further complicated by the possibility that the inherent institutional logic of the (West) German political economy may have forced it to define the problems of unification in a way that made them even more difficult to resolve than they would otherwise have been.

The West German response to unification was above all designed to protect the West German social order from being modified by the event. Unification was conceived and executed as a giant exercise in Institutionentransfer: a wholesale transplantation of the entire array of West German institutions to the former East Germany. This approach was supported by all major West German players, including business, labour, the conservative government, and the SocialDemocratic opposition. With respect to the economy, unification involved the immediate expansion to the East of socially circumscribed markets, negotiated firms, enabling state intervention and market-regulating associations. Immediately thereafter, national unions and employers' associations formally committed themselves to raising East German wages to West German levels within the next half decade, explicitly ruling out the establishment of a low-wage area in the East. In part this reflected a shared belief that, however low East German wages might be, German industry could never be price-competitive. But there was clearly also a fear that a low-wage regime in the East might erode the high-wage and high-skill regime in the West by opening up opportunities for low-wage production that might lure German firms away from the upgrading path of industrial virtue.

While its wages were being raised far beyond its productivity, East German industry was included in the rigorous competition regime West German firms had had four decades to learn to live with. Nobody can have been in doubt that this was bound to place the East German economy under potentially destructive adjustment pressures, with the likely outcome of prolonged mass unemployment. This, in turn, inevitably triggered massive financial transfers from West to East, given that among the institutions transplanted wholesale with unification was the West German welfare state. While it has been argued that these risks were difficult to gauge at the time of unification, it is questionable whether more realistic forecasts would have made much of a difference. Bent on protecting West German institutions, all relevant parties more or less consciously opted for a policy of trying to buy the East German economy into the West German high-wage system--at whatever cost to East German workers or West German taxpayers--in the hope that somehow the price would be less than catastrophic.

That hope may well be disappointed. By the mid-1990s united Germany was engaged in the largest wealth transfer in economic history, having committed itself for at least a decade to subsidise the neue Lander at a level of about US \$100 billion a year, to cover all manner of expenses, from public infrastructural investment to pension supplements and, not least, unemployment benefit. Still, there is no guarantee that this extraordinary redistributive effort will not in the end be self-defeating. Public debt has exploded since 1989, and may not be reined in for a long time--or only by cuts in the welfare state or in the research and development effort that would be obstructive of a quality-competitive 'social market economy' in more than one way. Also, world markets for German products, hardly large enough to provide full employment for West Germany and perhaps shrinking anyway for reasons of their own, may prove too small for Germany as a whole; the training costs of continued industrial upgrading, even if they might have been manageable for the West, may be too high for West and East together, especially as the latter has to be subsidised by the former; and the capacity of the West German economy for industrial innovation, perhaps already in decline, may not suffice to restore competitiveness to West and East Germany at the same time.

Eastern unemployment and, compared to the Western part of the country, regional impoverishment may thus become a lasting condition, thanks, paradoxically, to the excessively ambitious targets imposed on the neue Lander as part and parcel of Institutionentransfer. At the same time, abiding efforts to subsidise internal inequality down to a level compatible with institutional continuity may cause constant financial bleeding. Protracted economic stagnation and declining competitiveness may then unleash market forces strong enough to erode, gradually and under a growing risk of divisive political conflict, the very same institutions, and make impossible the kind of economic

performance that unification by Institutionentransfer was intended to preserve.

#### The challenge of globalisation

On the surface, it would seem hard to understand why a set of economic institutions as successful in world markets as the German one should be threatened by further economic internationalisation. But while the free trade regime of the postwar period left national boundaries intact--although allowing them to be crossed--globalisation abolishes them. The competitive performance of German high-wage capitalism requires continuous supportive as well as directive public or quasi-public intervention, inevitably organised at national level and dependent on a capacity, vested in the nation-state, to police the boundaries between the national economy and its environment. While versions of capitalism that require less state capacity for their governance may hope that the attrition of national boundaries under globalisation will leave them intact, this is quite different for a nationally organised economy like Germany.

The postwar German compromise between labour and capital, or between German society and its capitalist economy, was conditional on limited mobility of production factors across national borders. At its core was an institutionalised mutual accommodation of capital and labour markets--themselves both highly organised by government intervention and associative self-regulation--that turned less-than-perfectly mobile capital into a societal resource, and the financial sector into an economic infrastructure, for a pattern of production compatible with social objectives like low inequality. In exchange, society provided a labour supply willing and able to satisfy the economic requirements of high competitiveness in international quality markets. Globalisation, by increasing the mobility of capital and labour across national borders, extricates the labour supply from national control and enables the financial sector to refuse to continue doing service as a national utility. By internationalising, and thereby disorganising, capital and labour markets, globalisation dissolves whatever negotiated coordination may have been nationally accomplished between them and replaces it with the global hierarchical dominance of the former over the latter.

The West German labour market has long attracted foreign workers, so much so that by the late 1980s the number of foreigners living in West Germany had become far higher than in any other western European country. Still, the German mixture of immigration controls, effective enforcement of labour standards, full extension to immigrants of union representation and social rights and partial integration of foreign workers in training and retraining kept the supply of unskilled labour to domestic employers low enough to sustain labour market pressures for upward restructuring. The breakdown of communism in eastern Europe, however, has unleashed an inflow of

immigrants of a dimension that in the long term seems incompatible with high labour standards, an extended welfare state and a normalised pattern of high-wage and high-skill employment.

Unemployment in eastern Europe will change German labour markets even without direct immigration, much more so than the completion of the European Community's Single Market in 1992. It has always been part of the German model that low-skill jobs were to be allowed to move to low-wage countries, with job outflow ideally balanced by growth of, and training for, high-skill and high-wage employment. High long-term unemployment in the 1980s showed that achieving this balance was becoming difficult even when the Iron Curtain was still in place. Today the Czech Republic in particular has become a vast low-wage labour pool for German firms--and, unlike classical low-wage countries such as Portugal, one with a skilled workforce geographically close enough to Germany to be included in just-in-time production.

Accession of eastern European countries to the European Union, which Germany cannot resist because it is vitally interested in political stability behind its eastern borders, will remove the last remaining uncertainties for Western investors, most of whom will be German. It will also make construction of a 'social dimension' of the European Single Market, one that might protect German labour markets from the deregulating effects of internationalisation, even more difficult than it already is. The consequence will be a further increase in the availability to German employers of cheap, and sometimes not even unskilled, labour, undermining the German high-wage system by encouraging an outflow of jobs at a time of a growing inflow of workers.

As the German labour market is dissolving into its international environment, so is the German capital market. Financial capital was always more internationally mobile than labour, and West Germany was one of the first countries after the war formally to dispense with capital controls. But for a long time there was a number of effective impediments to capital mobility sufficient to allow for a meaningful distinction between German and non-German capital, and for the former to be governed by national institutions. For reasons related to national history and international politics, German finance capital was historically less cosmopolitan in outlook and enjoyed less international market access than British capital. Also, German banks' Hausbank mode of operation was and is hard to apply outside Germany; different national regulatory regimes made international operations costly to enter; and communication technology before the micro-electronic revolution slowed international capital flows, thereby limiting the size of the international capital market. As to German industrial capital, general logistical, organisational and political uncertainties combined with cultural idiosyncrasies of management and work organisation--as well as with the specific incentives offered by Standort

Deutschland, such as high-skilled labour and social peace--to keep the outflow of investment and jobs limited.

Globalisation has removed most of these constraints and turned formal into de facto liberalisation of capital markets. Financial internationalisation weakens the hold German banks have over the credit supply to German firms, which in turn weakens the banks' capacity and motivation to monitor company performance and promote prudent long-termism in company strategy. Large German firms seem to have for some time been making efforts to extricate themselves from the tutelage of their Hausbanken, in part because with globalisation their credit needs are beginning to outgrow the German market. Simultaneously, attracted by burgeoning international opportunities, the German financial sector is becoming more internationally minded, with even Sparkassen and Genossenschaftsbanken taking a keen interest in the global casino. As national boundaries wither away, and the German financial sector dissolves into a globally integrated financial services industry, the special relationship between German banks and German firms may increasingly become less 'relational' and more market-like.

#### The parochialism of nationally organised capitalism

If national boundaries are doomed to fall in the course of globalisation, making it impossible for nationally distinct versions of capitalism to remain distinct from their environment, could the German model not survive by being extended to the emerging global economy? Indeed, as the capitalist economy internationalises, some of the institutions that govern its German version are being adopted by other countries and international organisations. Unlike the Institutionentransfer of German unification, however, this process is highly selective, being strictly limited to institutions that make or accommodate markets to the exclusion of others, equally central to German capitalism, that socially embed and correct such markets.

1. International markets are constructed through diplomacy, not through the complex domestic class politics that gave rise to soziale Marktwirtschaft. They are therefore not likely ever to become embedded in similar protective-redistributive arrangements like the German markets. It should be noted that Germany, in coalition with the British and against the French, succeeded in extending its competition regime to the European Community, whereas its efforts to endow the Single Market with a 'social dimension', in alliance with the French and against the British, came to naught.
2. The German firm cannot serve as a model for corporate reorganisation in other countries. Co-determination is not based in the individual firm and its competitive interests, but in the broader German political and



institutional context. It cannot therefore be internationally extended. This holds even within the European Community, where efforts to export German company law, and with it the characteristic balance between capital and labour in the governance of large firms, were defeated by resistance not just from European capital, but also from most non-German trade unions. Moreover, German management practices, unlike Japanese ones, have never been successfully reproduced outside Germany, reflecting the dependence of German firms for crucial governance functions on a--national--skeleton of rule-setting institutions that an individual firm cannot and would not build on its own.

3. Even more than in Germany, what state capacity there is in the international economy is weak and fragmented. International efforts to mobilise state-like forms of public power for purposes of economic governance never got very far, not even in the European Community, which historically represents the most ambitious attempt at state-building above the nation-state. If monetary union is ever realised, the European Central Bank will be as insulated from political pressure as the German Bundesbank, and will operate under the same monetarist principles. Unlike the German state, however, the European quasi-state has no capacity to provide for equalisation of living conditions in its territorial subunits. Even more importantly, the German state's quintessential ability to replace direct state intervention and provision with assistance to organised social groups regulating themselves in the pursuit of collective goods--such as the infrastructural conditions of international competitiveness under high labour standards and a hard currency regime---cannot be replicated at the international level. Just as German Marktwirtschaft is being internationalised without its social correctives, German institutionalised monetarism is about to be transferred to the European Community without the associative self-governance that makes it sozialverträglich in Germany.
4. German associations prosper because of their close relationship to a facilitating state. No such state exists, nor can one exist, in the international economy. To the extent that the latter is a negotiated economy, it is negotiated between states, not between associations. Beyond the nation-state there are no organised social groups with the capacity to build and maintain a floor under international markets, or correct international market outcomes by negotiated redistribution. Other than states, the only major actors in the international arena are large firms, increasingly institutional in character, with ample resources to pursue their interests individually, unconstrained by union or government pressure forcing them into international class solidarity, and indeed with a growing capacity to extricate themselves from associative governance at national level, something they are increasingly likely to do in Germany.

5. German traditionalist culture would seem to be even less suitable for internationalisation. As Michel Albert has pointed out, Germans are as susceptible as anybody else to the attractions of non-traditional, 'American' economic culture? Compared with this, the slow-moving, conservative, collectivistic and all-too-prudent German system must inevitably seem boring and utterly devoid of 'fun'. In fact, there are many ways in which cultural internationalisation may disrupt the standard operating procedures of a densely organised society like Germany that thrives on long-term incremental improvement and requires stable commitments and suppression of opportunism. Just as German savers and investors may grow more *rechenhaft*, German managers, increasingly trained at US business schools, may want to be allowed to 'make decisions' like their US role models. And there are indications that the German vocational training system is about to be dramatically transformed by internationalisation, among other things by European Community 'harmonisation' of skill profiles in the unified European labour market.

Market-modifying and market-correcting political intervention in the economy, including publicly enabled associational self-regulation, can take place only within nation-states, because it is only here that the public power necessary for the purpose can be mobilised. Economic globalisation therefore erodes the conditions for such intervention and, by default but also by design, leaves only de-politicised, privatised and market-driven forms of economic order. It is above all for this reason that the German version of capitalism cannot be exported. Globalisation discriminates against modes of economic governance that require public intervention associated with a sort of state capacity that is unavailable in the anarchic world of international politics. It favours national systems like those of the USA and Britain that have historically relied less on public-political and more on private-contractual economic governance, making them more structurally compatible with the emerging global system, and in fact enabling them to regard the latter as an extension of themselves. It is this deregulatory bias of globalisation that seems to be at the bottom of Albert's pessimistic prediction that global competition will result in the perverse outcome of the less well performing Anglo-American model of capitalism outcompeting the better performing 'Rhine model'.<sup>[6]</sup>

## **Notes**

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1. The following stylised account draws on the typology developed in J.

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5. Michel Albert, *Capitalism Against Capitalism* (Whurr Publishers, 1993).
6. Ibid.

TABLE 1. The comparative performance of the German economy[a]

	Trade in goods and services as % of GDP[b]		visible exports as % of world total exports[c]		Trade (current account) balance as % of GDP	
	1988	1994	1988	1993	1988	
Germany	54.9	51.0	12.0	10.1	6.5	(4.0)
UK	48.7	50.8	5.4	4.8	-4.5	(-3.1)
Japan	18.0	16.7	9.8	9.6	3.3	(2.8)
USA	19.6	21.8	12.3	12.3	-2.6	(-2.6)

PART II

Hourly

	Trade (current account) balance as % of GDP	wages of workers, US = 100[d]
Germany	2.7 (-1.1)	160 (119)
UK	-2.1 (-1.8)[e]	91 (82)
Japan	3.4 (3.1)[e]	100 (66)
USA	-2.5 (-2.3)	100

[a] 1988: west Germany. 1994: United Germany.

[b] Trade data calculated on a balance of payments basis. Source: IMF, International Financial Statistics

Yearbook, 1994, and International Financial Statistics, June 1995.

[c] Exports calculated on an international transactions basis.

[d] In parentheses: in purchasing power equivalents. Source: R.B. Freeman, 'How labour fares in advanced economies', in: Freeman (Ed.), Working Under Different Rules (Russell Sage Foundation, 1994) p. 31, based on data from US Bureau of Labor Statistics, Hourly Compensation Costs for Production Workers in Manufacturing, 1992. German data refer to West Germany only.

[e] 1993.

TABLE 2. Wage spread

	D9:D5a		D1 :D5[b]	
	Early 1980s	Early 1990s	Early 1980s	Early 1990s
Germany	1.63	1.64	0.61	0.65
UK[c]	1.72	1.99	0.68	0.59
Japan[c]	1.63	1.73	0.63	0.61
USA	2.16	2.22	0.45	0.40

Germany: Gross monthly earnings plus benefits (calculated as 1/12 of 13th and 14th month pay plus holiday allowances plus Christmas allowances) of full-time, full-year workers. Source: German Socio-Economic Panel, waves 1-8. Calculated by Viktor Steiner, Zentrum für Europäische Wirtschaftsforschung, GmbH.

UK: Gross hourly earnings of persons paid on adult rates, whose pay for the survey week was not affected by absence. Data prior to 1983 include men under 21 and women under 18. Source: New Earnings Survey.

Japan: Monthly scheduled earnings of regular workers, 18-59 years old, at non-governmental establishments with at least 5-10 workers (varies by survey year), excluding agriculture, forestry and fisheries, private household services and employees of foreign governments. Source: Basic Survey of the Wage Structure. USA: Gross hourly earnings, computed as annual earnings divided by annual hours worked (annual weeks worked multiplied by usual weekly hours) of wage and salary

workers. Source: Current Population Survey.

[a] Ninth over fifth decile. Source: OECD Employment Outlook, July 1993.

[b] First over fifth decile. Source: OECD Employment Outlook, July 1993.

[c] Males only.

TABLE 3. Other indicators of inequality

	Intersectoral wage dispersion	Average earnings of workers in small enterprises as % of earnings of workers in large enterprises
	Freeman[c]	ILO Data[d]

Germany	17.7	14.9 (29)	90 (58)
UK	21.0	20.0 (20)	80 (40)
Japan	26.7	24.1 (20)	77 (68)
USA	27.3	24.8 (24)	57 (35)

## PART II

	Ratio of CEO earnings to average earnings of manual workers in manufacturing[b]
Germany	10.2
UK	15.5
Japan	7.8
USA	25.8

[a] Source: G. Loveman & W. Sengenberger, 'Introduction: economic and social reorganization in the small and medium-sized enterprise sector', in: W. Sengenberger et al. (Eds), *The Re-Emergence of Small Enterprises: Industrial Restructuring in Industrialized Countries* (International Institute for Labor Studies, 1990), p. 34. In parentheses: employment in small manufacturing enterprises, as percentage of total employment in manufacturing 1986/87. Small manufacturing enterprises are those with fewer than 500 workers. Sources: Z.J. Acs & D.B. Audretsch (Eds), *Small Firms and Entrepreneurship: An East-West Perspective* (Cambridge University Press, 1993), p. 228; Statistics Bureau of Japan, Management and Coordination Agency, Annual Report on the Labour Force Survey.

[b]Source on CEO earnings: The Wyatt Company. German and British data relate to large companies in all industries; Japanese data to companies of all sizes in all industries; US data to manufacturing firms of all sizes. To increase comparability, earnings are calculated as average earnings in the upper quartile of CEO earnings. Average earnings of workers: various national sources.

[c]R.B. Freeman, 'Labour Market Institutions and Economic Performance', *Economic Policy*, vol. 3 (April 1988), pp. 64-80, uses several indicators of inter-industry wage dispersion, calculated on different data as the variance of the logarithm of earnings by industry, multiplied by 100. The figures in the table represent the average of the three most recent indicators that include all four countries. The indicators are based on UN data from 1983, ILO data from 1984, and US Bureau of Labor Statistics data from 1986.

[d] Coefficient of variation of average wages and salaries of full-time workers at adult rates of pay between ISIC categories (industries). Source: ILO Yearbook, own calculations. In brackets the number of sectors over which the coefficient was calculated. Fewer categories are likely to underestimate the coefficient.

TABLE 4. Employment stability

	Median tenure in present job (years)	Average tenure in present job (years)
Germany (1990)a	7.5	10.4
UK (1991)	4.4	7.9
Japan (1990)[b]	8.2	10.9
USA (1991)	3.0	6.7

[a] 1990. Excluding apprentices.

[b] Regular employees (persons hired for an indefinite period); temporary workers hired for more than one month; daily workers hired for over 17 days, in private establishments with over nine employees.

TABLE 5. Unions and collective bargaining

	Unity density[a]				Collective bargaining coverage[b]		Variation in coverage rates by industries
	1980	1985	1988	1990	1980	1990	1990[c]
Germany	37.0	37.4	33.8	32.9[d]	82	82[e]	0.14
UK	50.7	45.5	41.5	39.1	70[f]	47	0.34
Japan	31.1	28.9	26.8	25.4	28	21[g]	0.74
USA	23.0	18.0	16.4	15.6	26	18	0.61

[a] Employed members only. Sources: 1980, 1985, 1988: J. Visser, 'Trends in trade union membership', in: OECD Employment Outlook, July 1991, pp. 97-134; 1990: OECD Employment Outlook, 1994.

[b] OECD Employment Outlook, 1994. The German figures are estimates supplied by the WSI, a research institute of the German Trade Union Confederation (DGB). The Bundesarbeitsministerium (Federal Ministry of Labour) reports a coverage rate of 90 and 91 per cent for the two years; the OECD source uses the government data.

[c] Coefficient of variation. Source: see b.

[d] West Germany.

[e] West Germany.

[f] 1978.

[g] 1989.

TABLE 6. Employment and unemployment

	Average unemployment rate[a]			Long-term unemployment[b]	
	1981-85	1986-90	1991-94	1990	1993
Germany	6.4	5.8	5.4[c]	46.3	40.3[c]
UK	11.3	8.8	9.7	36.0	42.5
Japan	2.5	2.5	2.4	19.1	17.2
USA	8.2	5.8	6.7	5.6	11.7

[a] OECD standardised unemployment rates, defined as the number of persons unemployed as a percentage of the total labour force (including the self-employed and the armed forces). Unemployed persons are persons aged 15 and over who (1) are without work, (2) are available to start work within the next two weeks, and (3) have actively sought employment at some time during the previous four weeks (definition adopted from ILO and used by both EUROSTAT and OECD to calculate standardised rates). OECD Employment Outlook, various issues.

[b] From survey-based data. Long-term unemployment is defined as the percentage of the unemployed that have been out of employment for 12 months or more. Source: OECD Employment Outlook, 1992 and 1995.

[c] West Germany only. According to EUROSTAT, the rate for united Germany was 7.1 percent.

[d] Data refer to united Germany.

TABLE 7. Working time

Average hours worked per person and year[a]

	1973	1983	1993
Germany	1804	1668	1534[b]
Japan	2185	2095	1965[c]
USA	1831	1754	1743

[a] Source: OECD Employment Outlook, July 1993. Data include part-time work. Germany and USA: dependent employment only; Japan: total employment.

[b] West Germany only. No data for united Germany available.

[c] 1992.

TABLE 8. Labour input

	Labour force participation total (females)[a]		Average yearly rate of change in employment, 1983-1990[b]	
	1979	1992	Males	Females
Germany	68.3 (52.2)	69.8 (59.0)	0.9	1.7
UK	74.3 (58.0)	75.1 (64.5)	1.2	2.9
Japan	71.8 (54.7)	75.5 (61.7)	1.0	1.6
USA	72.1 (58.8)	76.9 (68.9)	1.7	2.8

## PART II

Percentage  
change in  
resident  
population,  
1970-1988[c]

Germany	0.8
UK	2.6
Japan	18.6
USA	20.1

[a] Total labour force, divided by the population of working age (15-64) at mid-year. Source: OECD Employment Outlook, July 1993.

[b] Source: OECD Employment Outlook, July 1993.

[c] Source: The Economist Book of Vital Statistics, 1990, p. 18.

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*edited with Joel Rogers.*

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